

**THE TRANSFORMATION OF
THE HOUSING FINANCE
SECTOR IN HUNGARY
1989-1998**

**MACROECONOMIC
CONSIDERATIONS**

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Prepared by

József Hegedhs

Katalin Zsomboki

Metropolitan Research Institute



THE URBAN INSTITUTE

2100 M Street, NW

Washington, DC 20037

(202) 833-7200

www.urban.org

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THE TRANSFORMATION OF THE HOUSING FINANCE SECTOR IN HUNGARY, 1989-1998

MACROECONOMIC CONSIDERATIONS

INTRODUCTION

In the decades before the change of the regimes, most Eastern European countries regarded housing as a priority issue. The housing situation was—and indeed continues to be—a basic element in measuring living standards and has been an indicator of the success of the economic development. Since the late 1950s, housing and the “solution” of the housing problem had been a first priority in all Eastern European countries, including the Soviet Union. The state controlled both the demand and the supply sides in the housing sector and prevented the emergence and integrating operation of market mechanisms. The most important elements of this model were the measures “against luxury housing,” the policy of “closed cities,” and the “one family/one housing” principle, as well as a permanent shortage of construction materials in the private sector and a strict employment policy. However, as a result of different economic development strategies in the 1980s, outcomes largely differed. The “deviation” of the Hungarian housing system from the mainstream accelerated in that period; housing investments both by the state and citizens significantly grew. Housing was the product that people were allowed to consume within certain limits. In this way the state tapped extra incomes generated in the second economy and did not let such incomes be used in the productive sphere. A tentative conclusion is that, until the mid-1980s, there was an “over consumption of housing” in Hungary, which is measured by the relatively high ratio of housing expenditures to the GDP and the fact that the general housing conditions were good for that economy.¹

After the change of the regime, the housing sector has changed dramatically. The real estate market has quickly transformed, former huge construction companies have been split and privatized, the construction materials commerce has been liberalized, limits/constraints of owning property have been lifted, and a significant portion of housing has been privatized. All this has paved the way to a market-oriented housing model. However, there have been many signs that the transformation process is not that smooth. Housing construction rates have fallen, the housing stock has further deteriorated, cooperation between occupants of privatized and non-privatized units has been problematic, that hinders proper maintenance and renewal, housing expenditures have been taking an increasing part of households’ incomes, and housing arrears have become a social issue.

The housing finance system is clearly a crisis sector of the transforming housing industry illustrated by the decreasing housing loan/housing value ratio, the declining volume of loans over the years, and a shrinking share of housing loans in the loan portfolio. This paper attempts to explain and analyze the place

¹ All this, however, was the result of increasing social inequalities, a distorted relation between the economy and the housing system, as well as a very expensive subsidy system that did not meet social criteria and was to be paid by coming generations. Briefly, the country spent a lot on housing in a wasteful and socially unjust way.

of the housing finance system in the housing sector and in macroeconomic processes.²

(The housing loan data of OTP cannot be published in other studies or in newspapers.)

THE CHANGING POSITION OF THE HOUSING SECTOR IN THE ECONOMY

The basic question is in what ways macroeconomic processes have affected the housing sector in the past ten years, and more specifically, what kind of transformation processes have occurred within the housing finance system.

In the housing sector, sound demand comes from households' incomes supplemented by housing loans and subsidies. However, the size of housing loans directly depends on households' ability to pay, thus the basic determinant of demand is households' income position and preferences. The housing subsidy system and the institutional background may stimulate the demand; however, they cannot change it profoundly.

Households' demand for housing is fundamentally impacted by their savings and the way savings are realized—that is, the portfolio decisions of the population (whether the saving is kept in cash, securities, or goods, of which housing is one possibility). For a part of the households, housing is a type of saving, as housing preserves its value.

Owing to macroeconomic changes and the restructuring of the economy, the income position of households has deteriorated. The fall in incomes in real terms has led to a decrease in household consumption including housing demand (the income impact). Real incomes have declined by 10 to 20 percent in this period in an environment of high inflation rates. At the same time, household preferences have induced changes in the consumption structure, which have been amplified by changes of (relative) prices of various products and services.

² In the paper we used the valuable information and thoughts of our colleagues Sándor Erdősi, Éva Gerőházi, and Judit Bányai from MRI. We would also like to thank Krisztina Óvári (OTP), Dr. Edit Kakuk (Postabank), Balázs Horváth (K&H), and Aranak Tihanyi (OTIVA) for their housing credit data. In our work, we also relied on the analysis of Doug Diamond from the Urban Institute on the housing savings banks and on the DPM.

Table 1
Macroeconomic Indicators Between 1991 and 1997

	1991	1992	1993	1994	1995	1996	1997
Consumer Price Index (previous year 100)	135	123	122.	118.	128.	123.	118.
GDP (HUF billion) at market purchase price	2,49	2,93	3,53	4,36	5,61	6,84	7,14
Total investment (HUF billion at current price)	492	556	638	843	1,03	1,33	1,44
Per capita real income (previous year 100)	98.3	96.5	95.3	102.	94.7	99.9	N/A
Real earning (previous year 100)	93	98.6	96.1	107.	87.8	95.0	104.
Household savings (HUF billion)	238.	284.	213.	359.	436.	583.	751.
Housing investment (HUF billion at current	45.6	93.3	92.6	89.0	122.	180.	278.

Source: Central Statistical Office

As a result, housing expenditures of households relatively increased and the structure of such expenditures has dramatically changed. The proportion of housing investments has decreased by 40 percent (from 10 to 6 percent) while housing maintenance and operation costs have augmented from 10 to 18 percent (see Table 2).

Table 2
Housing Expenditures in Household Spending in 1989 and 1996 (in percent)

	1989	1996
Housing investment	10.1	5.8
Housing maintenance	10.3	17.9
Total	20.4	23.7

Source: Household Survey, HCSO

In the past ten years, housing expenditures of households have decreased in real terms as the fall in real incomes has not been set off by a moderate increase in the proportion of housing costs. A basic cause of the decline in housing investments is shrinking demand in the household sector. A more important trend, however, is that in housing related expenditures housing maintenance costs have increased to the detriment of housing investments. This change is a logical product of the transition to a market economy.

In the 1980s, a considerable portion of housing demand was "speculation." Investing in housing was one (single) type of profitable savings for housing prices increased more than the

inflation rate³ and there was almost no other savings alternative with similar profit prospects. After the political changes, however, the demand for housing as a type of saving decreased (new favorable forms of investment money have appeared) as a consequence of and resulting in the drop in housing prices. This fact also impacts the supply side, not only because there is no new (speculative) demand, but also because those having bought housing as speculation now appear on the supply side. The portfolio decisions of households changed.

Table 3
The Comparison of the Yield of the OTP Deposit Account (12 Months) and of Real Estate Investment

Year	OTP interest on	Real yield of	Rise of real	Real yield of	Difference
1989	17.0	100.0	25.0	106.8	6.8
1990	24.0	98.4	22.0	103.4	5.0
1991	30.0	94.8	8.4	83.1	!11.7
1992	26.0	97.1	21.2	81.8	!15.2
1993	17.0	92.7	11.5	74.5	!18.2
1994	20.0	93.7	11.0	69.6	!24.1
1995	20.7	87.7	18.0	63.7	!24.0
1996	21.4	86.6	14.0	59.1	!27.5
1997	12.5	82.3	11.0	55.4	!26.9

Source: OTP, expert estimates

Comparing the yield of the one-year OTP deposit account and the estimated yield of the housing market portfolio shows that investments in the real estate market yield much less than the financial market. Even if the accuracy of this calculation is doubtful, because of the large margin of error in housing price estimates, the existence of this trend is unquestionable. Data on savings indirectly reinforces our earlier conclusion. From the housing finance perspective, two trends have to be highlighted. On the one hand, in the competition for savings securities and insurance savings, which in the long run are potential investors in the housing market, have gained in importance. On the other hand, fluctuation in savings is to be explained by the hypothesis that savings invested in real estate have been liquidated (see Table 4). Assuming that 10 percent of housing assets had been acquired for speculative reasons (to preserve the value

³ Based on real estate prices in rural cities between 1982 and 1986, housing prices are estimated to have grown by 10 to 12 percent while inflation was much lower. In these years, real estate investment (first and holiday homes) was profitable. This result is underlain by the analysis of Zsoldos (1997) on macroeconomic trends.

of savings) and owing to changes in the market it has dropped to 5 percent, HUF 400 billion at current prices or HUF 150 billion at 1991 prices have been liberated. Not only amortizing housing loans (HUF 120 billion in 1991 alone), but also housing privatization must have tied up a substantial part of savings.

Table 4
The Structure of Savings in 1991 Through 1997 (HUF Billion)

Year	Cash	HUF	Small	Securities	Life and	Hard	Savings	Loans	Net
1991	23.2	106.7	20.9	23.0	6.8	58.0	238.6	110.5	349.1
1992	57.1	173.4	4.3	22.5	4.0	23.1	284.4	26.1	258.3
1993	48.6	71.8	5.0	25.2	10.8	52.1	213.5	47.6	165.9
1994	38.5	105.8	11.2	121.1	6.5	89.0	359.9	38.0	321.9
1995	47.2	135.2	1.9	80.7	25.9	145.3	436.2	42.2	478.4
1996	44.7	298.9	14.7	130.8	48.9	45.8	583.8	129.0	612.8
1997	55.4	358.6	18	200.9	70.4	47.8	751.1	47.5	703.6

Source: National Bank of Hungary

Other important factors of housing demand are the number of households and their regional mobility. Declining population and slowing regional mobility definitely lead to a decline in demand.

International comparison of the most important (statistically manageable) indicators clearly shows that the housing situation in Hungary is surprisingly better than in other (not Eastern European) countries with similar income, and is often fairly close to Western European standards. In Hungary, housing units are less crowded, the average size per person is larger, and the size of units per 1,000 persons is larger (Hegedhs, Mayo, Tosics, 1996; Farkas, 1995). Quantitative indicators show an upward trend even in the 1990s which, however, is caused by demographic processes rather than by housing investments. By the early 1990s the so called quantitative housing shortage was eliminated, i.e., there were more housing units than households, pointing out that the nature of the housing problem has changed in the 1990s (see Table 5).

Table 5
The Housing Situation Between 1970 and 1996

	1970	1980	1990	1996
Housing stock (1,000)	3,122	3,542	3,853	3,991
Number of dwellers per 100 units	318	292	263	250
Number of dwellers per 100 rooms	193	146	110	104
Number of households (1,000)	3,328	3,719	3,890	3,867
Number of households per 100 units	108	105	101	97

Source: Micro census, HCSO 1997

Housing demand has been greatly impacted by privatization. Of 720 thousand units, 500 thousand has been purchased by sitting tenants, many of which appear in the housing market (see Table 6). Generally, with the decline of real incomes, “over consumption of housing” has significantly fallen. These facts have negatively affected demand because buyers could choose from an increasing supply of existing housing.

Table 6
The Stock, Sales, and Proportion of Municipal Rental Housing

Area	Municipally owned units			Units sold (%)	Municipal units
	Stock	Sales	Stock		
	<i>Thousand</i>				
Nationwide	721.3	513.3	208.6	71.2	5.2
Budapest	395.8	282.0	114.2	71.2	14.0

Source: HCSO

Furthermore, the relative prices of new and secondhand housing have changed as the real value subsidies for new housing has diminished and some of the subsidies (e.g., local subsidies) have been extended to secondhand housing. Growing prices of construction materials and disappearance of cheap construction land have made new constructions expensive. These market processes have led to the decline in housing constructions and to the crisis.

HOUSING INVESTMENT

In international comparison, housing investment amounts to 3-8 percent of GDP or 15-30 percent of all investments (Buckley, 1989, p. 2).

The share of housing investments in GDP and in all investments shows that the relative weight of the housing sector in the economy is little (see Table 7). Relative figures, both in terms of GDP and total investments, have been close to lower figures of comparative international data, and in 1993 and 1994 they were even lower.

Table 7
The Share of Housing Investments in GDP 1991-1997

Year	GDP	Investments	Housing investments	Share of housing	Share of housing
1991	2,498	492	93	3.7	19.0
1992	2,935	556	93	3.2	16.7
1993	3,538	638	89	2.5	13.9
1994	4,365	843	122	2.8	14.5
1995	5,614	1,039	181	3.2	17.4
1996	6,845	1,338	279	4.1	20.8
1997	7,147	1,445	327	4.6	22.6

Source: HCSO

Within housing investments, there are three areas with specific financing and subsidy features in each.

- New housing construction
- Housing renewal and modernization
- Purchase of secondhand housing⁴

⁴ From the point of view of statistics, this cannot be regarded as an investment because the transaction takes place within the household sector. However, from the aspect of housing finance and housing credits, this is a very important sector, which impacts the housing policy significantly as well.

New Housing Construction

Housing construction is estimated to amount to 70 percent of all housing investments.⁵ An overview of housing construction data helps see the decline in housing construction.

Table 8
Housing Constructions and Their Decline

Year	Number of construction	Number of housing	Number of housing	Average size (m ²)
1980	—	89,065	17,978	67
1985	—	72,507	12,490	79
1990	—	43,771	7,435	90
1991	—	33,164	5,471	90
1992	24,057	25,807	4,540	93
1993	20,245	20,925	4,505	95
1994	27,152	20,947	5,067	97
1995	39,053	24,718	6,423	99
1996	30,462	28,257	6,584	97
1997	30,474	28,130	6,959	95

Source: Housing Statistics by HCSO

The lowest point with 21 thousand new housing built was in 1993; then constructions slowly increased until 1996 or 1997 with 28 thousand units built. The number of demolitions increased by 50 percent after 1993, which means that 7 thousand new units amount to only 4.5 thousand net increase. This information is especially important in evaluating the impact of the raise of the housing construction subsidy in 1994.

On the housing investment side, fundamental and unfavorable changes have occurred. OTP⁶ and municipalities have stopped investing and private developers have not been able to step in the vacuum, thus housing construction is left to households who build their own housing.

⁵ There are but rough estimates on the real volume of housing renewal. The Hungarian Central Statistics Office has no reliable data and applies the 70 percent estimate.

⁶ The housing investment activity of OTP was transferred to OTP Real Estate Co. The decline in organized housing construction is due to changes in the market, notably the shrinking demand.

Experts do not agree on how serious problem the fall in housing construction is. The issue is an important one because it has implications for identifying policy priorities. Basically, there are two sets of arguments:

Catastrophe theory. The housing sector is in deep crisis; the lack of construction threatens the restoration of macroeconomic processes and leads to a mass-scale housing problem hitting the middle strata too.

The structural adaptation theory. The decline in housing construction is the sign of the rational behavior of households who restructure their savings and housing expenditures because of disadvantageous macroeconomic conditions.

An important argument in the Catastrophe theory is that in soundly functioning economies annual new housing construction should amount to 1 percent of the existing housing stock, which would be 40 thousand units in Hungary. Often the deficit is aggregated over several years, which means 100,000 missing units in 1997. Nevertheless, if the 1 percent of the housing stock is measured in terms of value or surface area, the outcome is different. Housing construction in terms of surface area was less than 1 percent in 1993 and 1994, while in terms of value it has always exceeded 1 percent (see Table 9).

Table 9
The Share of Housing Investments in the Housing Stock in Terms of Surface Area and Value

Year	Surface area of	Total surface	Percentage of	Value of the	New	Value of new
1991	208,600	2,891	1.39	3,137,010	64,758	2.06
1992	215,454	2,336	1.08	3,646,979	64,240	1.76
1993	221,029	1,961	0.89	3,914,376	61,772	1.58
1994	225,939	2,116	0.94	4,655,120	84,640	1.82
1995	225,939	2,440	1.08	5,555,757	125,416	2.26
1996	240,197	2,720	1.13	6,972,749	193,392	2.77

Source: Central Statistical Office

These data are of some help to understand the issue yet do not underlie either theory. It would be important to know the volume of renewals for the housing policy dispute centers around the relative actual and desired volume of new constructions and renewals (expansions, loft conversions and modernization) rather than the absolute volume of housing investments.

Housing Renewal, Modernization, and Expansion

Several experts estimate the total housing assets in Hungary at HUF 7 to 9 billion (in 1998).

However, experts do not agree on the issue of housing renewals. The first issue is the need for housing renewal. A team of experts estimated the total need for renewals, referred to by professionals as “deferred renewal,” at HUF 1675 billion in 1994. The term deferred renewal, however, must be cautiously treated sociologically and economically. Basically it is a technical approach that has to be evaluated in terms of the economy’s and households’ capacity and willingness to pay, too.

According to another theory, in order to maintain the housing asset and preserve its value, 1.0 to 1.6 percent of its value should be spent on the housing annually (in addition to new investments). Based on the current value (and not the replacement value), this means that annually HUF 70-114 billion should be spent on the housing stock to prevent it from losing value. To this estimated amount, the demand for modernization (improve energy efficiency and increase the comfort level) has to be added—HUF 100-150 billion.

As a matter of fact, changes in the housing investments of the household sector, realized in the area of renewal and modernization, is much more important. Information from several sources tend to contradict as the term renewal is ambiguous and making it operational is difficult. (The Central Statistical Office applies the 30 percent rule of thumb.)

The likely need determined by the technical approach is far beyond realistic possibilities. It is up to the housing finance system and the housing policy to re-rank priorities in response to real data (economic and technical analyses) and to encourage households to do deferred renewals.

The Secondary Housing Market

Households’ gross housing investments include the purchase of secondhand housing, the revenues from which stay within the household sector. Financing such transactions is potentially a gigantic market for the housing finance sector. This sub-market operates primarily on a cash basis.

It should be interpreted as a step towards a market-based housing system that in the 1990s, *the housing price/income ratio* (average housing price divided by the average annual household income) *has dropped from 6.1 to 4.9* in our estimates for housing prices have increased less than incomes.

Nonetheless, the difference between cheap and expensive housing has grown and the market has polarized due to the fact that housing prices have increased less than the inflation rate but housing prices have grown (in nominal terms) at different rates in various sub-markets. One of the reasons for this is that *income differences have grown*. The difference between the lowest

and highest income deciles went up from 5.8 in 1987 to 7.0 in 1994 (Galasi, 1995).

The polarization of market housing prices has affected buyers of first housing and those already present on the housing market differently. As the real price of sub-standard housing (often expensive to maintain) has decreased, the market position of first housing buyers has relatively ameliorated; they can buy housing for an amount worth two years' average income. For mobile families, however, who have to pay the difference between cheap and more expensive housing, the gap between housing prices and income has increased which underlies the observation that moving on has become extremely difficult (see Table 10).

Table 10
Housing Price/Income Ratio in First Housing Buyers and Mobile Families on the Housing Market

	1990	1996
First housing buyers	4.2	2.0
Mobile families	3.8	5.2
Average unit	6.1	4.6

Assumptions: The difference between "first" units and units bought by mobile families is 12; the difference between the inflation rate and housing price growth rate is 12.

In the 1993 Hungarian Household Panel Survey, 300 thousand households (8 percent) said that they would move next year to a newly built unit or to one they would buy.⁷ Housing mobility is still very low, although higher mobility rates would mean a potential area for the housing finance system. Housing mobility helps better use the capacity of the housing stock and its positive relation to housing modernization, and renewal is evident. (Over 50 percent of moving households do some kind of renewal in their units.)

⁷ It is worth noting that in the 1995 Budapest Rental Housing Panel Survey, 8.4 percent of households said they would like to move in the next one or two years, and that a larger share of households who have bought or would buy their units wanted to move than those who have not bought their units.

HOUSING FINANCE AND SUBSIDIES

Housing Finance Crisis

The housing finance sector has shrunk in recent years. This trend can be illustrated by two indicators. The first is the measure of collateralization, i.e., what percent of the value of the housing asset is financed by the outstanding loans (the stock indicator). The other indicator is the portion of housing loans in all housing investment resources (the flow indicator).

Table 11
The Role of Loans in Housing Financing From 1991 Through 1997

Year	Housing	Housing	Loans/	Value of	Housing	Housing	Housing
1991	93,317	20,450	21.9	3,037	276	9.1	39.1
1992	92,570	18,931	20.5	3,485	173	5.0	25.0
1993	89,013	18,976	21.3	3,699	192	5.2	28.4
1994	121,966	16,788	13.8	4,307	186	4.3	23.8
1995	180,724	20,438	11.3	5,024	169	3.4	18.3
1996	278,678	11,463	4.1	6,237	149	2.4	12.4
1997	327,149	9,066	2.8	7,367	136	1.8	8.0

Source: HCSO

Loans outstanding fell from 9.1 percent in 1991 to 5 percent in 1992 as a result of the hike in interest rate of loans given prior to 1989 and the removal of subsidies. As of 1994 the loan/housing asset ratio fell again as a result of the mechanism of the subsidized loan schemes issued between 1989 and 1994. The amount of the subsidy is drastically reduced every five years to encourage borrowers to repay loans (and even to renounce the subsidy).

The loan/investment ratio shows a similarly grim picture, even though the indicator is positively skewed because housing investments do not include purchases of secondhand housing while in the provision of loans this sub-market is not negligible. The role of loans fundamentally changed in 1994 when the loan amortization subsidy was abolished and the interest subsidy was introduced as well as the social policy allowance was raised and its name was changed to housing construction allowance.

The rate of construction period loans to corporate loans shows a similar trend—it fell from 39 percent in 1991 to 8 percent in 1997.

In recent years housing policy experts have attempted to give various explanations for this sharp decline in housing loans:

In the banking system the amount of long-term resources is limited, which makes lending short-term resources for a longer term expensive—although it would not be impossible in a modern housing finance system.

Investment resources can be used much more efficiently elsewhere than in the housing sector.

The need for resources in the budget crowded out retail demand.

Meeting the demand of the corporate sector has preceded the housing sector because of lending costs and discretionary considerations.

Sound demand for loans has fallen due to the changes in saving in preferences of households and the modifications in the subsidy system.

In an inflation ridden environment, the ability to borrow necessarily decreases, which is somewhat moderated but not eliminated by DPM.

The decline in housing loans is only illusory for the process takes place along with institutional changes. In the 1990s, the shift towards a market-oriented housing sector reevaluates the role of loans; unsolved and unknown loan risks increase real interest rates which, in turn, reduce demand.

High real interest rates are induced by the lack of competition in housing loans. Despite the creation of new banks, OTP has retained its monopoly.

The decline in the lending sector is caused by a set of several factors rather than by any single factor.

Three sets of factors hinder the expansion of housing finance:

Solvency. It must be true, though not in general terms, that demand of a wide stratum of households for cars and their ability to pay contradicts this assumption.

Loan risks. This seems to be a valid explanation. The real problem, however, is that loan risks and the legal system encompass many actors of whom any single can block the whole system (for instance, courts or the politics).

Costs of transactions (underwriting, information systems) are too high and the return is ensured only in large volume loans that no single bank is able to provide.

In our opinion, the explanation lies in the behavior of the household sector, in macroeconomic conditions as well as in the distorting effects of the institutional and subsidy systems.

Emerging Competition in Housing Lending

Despite the shrinking of the housing finance system, competition has increased among banks and finance institutions. Although the outcomes of this competition are not yet known, it seems that actors in the housing finance market are preparing for the growth in demand. Based on international experiences, banks are well aware that they must open up for housing finance if they want to be competitive. In developed countries the housing finance sector (mortgage loans, secondary mortgage market, etc.) has been one of the most dynamic sectors in financing in recent decades. Signs of competition have appeared in the area of retail lending, construction period loans for developers, primarily in terms of developing loan schemes and building capacities. Yet, there has been no competition in prices. Housing savings banks compete, too, though their main activity is not lending but collecting deposits.

Retail Lending

In 1989 OTP had almost total monopoly. It controlled 95 percent of the market in the area of housing financing. By 1994 its market share went down to 89 percent and, although OTP's position in retail housing financing is still very strong, it continues to dwindle. Currently seven banks provide retail housing loans⁸ and several new banks try to enter this sub-market.⁹

Apart from loans (both subsidized and market price) for buying, building and renewing secondhand and new housing, new housing loan schemes have been developed and several banks provide consumer loans,¹⁰ which can be spent on buying housing. OTP and Postabank provide quick loans related to housing

⁸ OTP, Postabank, Takarékbank, K&H, HBW Express, and CIB Bank, and as of 1998 the Földhitel és Jelzálog Bank (Mortgage Bank)

⁹ For instance, Erste Bank and Daewoo.

¹⁰ Budapest Bank, Citibank, and Konzumbank have provided large enough personal loans to buy housing. Generally the interest rates are very high (33 percent) in these loans, and banks require very high net income. In Hungary these loans are a substitute for credit card schemes and their role in the

savings apart from classical housing loans. K&H provides bridging loans and clearing loans.¹¹

Except for the Földhítel és Jelzálogbank (Land Credits and Mortgage Bank), all banks that provide housing loans offer loans for renewals with similar loan terms as housing loans.

Since 1992 the total retail loans outstanding in Hungary have fallen by 22 percent—from HUF 173 billion to 136 billion. In real terms this decline is 70 percent. The annual lending by OTP—the largest bank issuing housing loans—has fallen by almost half since 1994, and this decrease is not even closely balanced out by the growth of the volume of loans given by other banks (see Table 12). There are no data available on housing loans by Jelzálogbank (Mortgage Bank), HBW Express, and CIB Bank, which have recently started their housing finance activities and consequently their relative weight is very little.

Table 12
The Number and Volume of Housing Construction and Purchase Loans From 1994 Through 1997

Year	OTP ^a			K&H ^b			Postabank
	Number	HUF	% change	Number	HUF	% change	Number
1994	66,609	17.1					
1995	49,756	18.7	+ 9				
1996	25,948	10.3	!45	75	77		
1997	20,227	9.3	!10	262	230	+300	140

Notes

a The figure includes all loans issued for construction, purchase and renovation

b Including the very few renewal loans

Source: Data from banks

OTP in 1997 issued almost 10,000 fewer loans than in 1993 for new housing construction. The number of new loans for buying secondhand housing is much lower than in 1993, too. Within the shrunk demand for loans, the demand for financing the purchase of secondhand housing has considerably increased from 32 percent in 1990 to 63 percent (see Table 13), while in 1997 the share of the volume of the loans for new housing was close to that of the loans to buy secondhand housing (49 and 50 percent, respectively). Nearly two-thirds of loans for constructing or buying

housing market is but subsidiary.

¹¹ A bridging loan with a 12-month maturity period can be requested to buy new housing. The loan is repaid from the sales price of the old housing of the client. The amount of the loan can be as large as the total price of the new housing but not more than 50 percent of the old one. Clearing loans are issued to pay back previous housing loans when the client wants to move.

housing were subsidized loans (see Table 13).

Table 13
OTP Loans for Constructing and Buying Housing in 1997 (Renewal Loans Not Included)

Type of the loan	Number (percent of all)	Amount (percent of all)
New constructions/purchases	36	50
Secondhand housing	63	49
DPM	10	21
Subsidized loans for housing construction	20	N/A

Source: OTP

K&H started its housing financing activity in 1996. Although housing financing of the bank has grown more than threefold from 1996 through 1998, it has a very small share in the housing market (its housing purchase loans amount to as little as 2 percent of OTP's loans). As the bank is not planning to provide centrally subsidized loans (housing construction subsidy), it will be able to meet only a very little portion of the need for new housing and their loans tend to finance the purchase of secondhand housing.

Savings Bank's cooperatives provided housing loans as early as before 1989 serving 5 or 6 percent of the market. Savings cooperatives regard housing loans extremely risky because of the difference of the maturity periods of deposits and loans. After 1989 the number and outstanding amount of housing loans issued by cooperatives has dramatically decreased and cooperatives prefer to invest in state bonds ensuring larger profits. Nevertheless, savings co-ops seem to have retained their relative market position; in 1997 they owned 6 percent of outstanding housing loans. Most of the loans (about 85 percent) issued by cooperatives of the Savings Bank are to buy new housing. The Savings Bank is planning to introduce DPM loans.

Table 14
Housing Loans by the Savings Bank

Year	Outstanding loans	Changes in outstanding loans (percent)
1994	11,463	—
1995	10,130	!12
1996	9,023	!11

Source: Savings Bank

Data from the Savings Bank show that its outstanding loans fell by 24 percent between 1994 and 1997. This trend, however, stopped in late 1997 as evidenced by data from the first six months of 1998. Savings cooperatives have developed new housing loan schemes in conjunction with housing contract savings, which increased demand for loans by 5 percent.

Loans by banks that have recently entered the housing loans market are not considerable yet. These banks have engaged in retail loans in the hope of a market boom.

Table 15
Terms of Housing Loans in Various Banks

Name	Interest	Own resource	Loan limits	Average loan size	Loan/value ratio
OTP	26-27	Subsidized loan – 40%; Non-subsidized loan – 60%	upper limit in function of income With housing construction subsidy not more than HUF 2, 8 million	new housing – HUF 700 thousand secondhand – HUF 400 thousand	new housing – 6-7% secondhand housing – 10-16%
K&H	25	50%, in renewals – 30%	200 thousand – 8 million (any amount with special procedures)	HUF 700 thousand	
Postabank	25-26	30%	300 thousand – no limit, not more than HUF 500 thousand for renewals	No data available	
Savings Bank	24	30%	Changes, usually no lowest limit and usually HUF 2 million as upper limit.	HUF 1 million (including the construction subsidy)	40% (including the construction subsidy)

Table 15 (Continued)

Name	Interest	Own resource	Loan limits	Average loan size	Loan/value ratio
Land Credit and Mortgage Bank	24-26	40%	HUF 3-20 million	No data available	
HBW Express	29-30	50%	HUF 1 million – no upper limit	No data available	No data available
CIB Bank	26, 75	No data available	HUF 500 thousand	No data available	No data available

Notes

a Monthly amortization must not exceed 33% of the income.

b This figure is distorted as loans for secondhand housing include loans for buying rental housing and expansion of the unit. Without these cases, the average loan size is HUF 400-500 thousand.

Source: Data from banks

One measure of the demand for housing loans is that the average size of housing loans in OTP, Postabank, Savings Bank, and K&H is HUF 400 thousand to HUF 1 million, which finances but a small portion of the price of an average housing unit. As these banks provide the majority of total outstanding housing loans, the transactions of new banks on the market would not significantly change the average loan size.

Although required own resource ranges from 30 to 60 percent, in practice builders or buyers of housing finance at least 50 percent of their housing. In the early 1990s OTP loans financed 30 percent of the cost of the housing on average, and this share gradually decreased to 24.8 percent by 1993. Currently, loans for new construction finance 6 or 7 percent of costs. Of loans for secondhand housing, loans for resale finance some 10 percent of the value of the housing and 16 percent in private sales. In the case of savings cooperative loans, required own resource is as low as 30 percent, though in practice builders and buyers put up 60 percent of the price of the housing. The average loan is HUF 1 million, which includes the housing construction subsidy which in fact is the large part of the loan. The average loan/value ratio is 40 percent which includes the housing construction subsidy and without it the ratio probably would not be higher than in OTP.

The reason why the loan/value ratio of loans for new housing is low is that the housing construction subsidy in these loans amounts to as much as 30-40 percent of the cost of the housing. The ratio has not changed in recent years and the amount of the subsidy has been very large and important in housing construction and demand for loans.

The amount of renewal loans is generally less than 50 percent of the value of the property, though the limits are of a wide range. Postabank sets the limit at HUF 500 thousand while K&H at 30 percent of renewal costs. In 1997 OTP, dominating the market, gave renewal loans worth

HUF 1.7 billion which financed 2.4 percent of renewal costs. In OTP the average construction cost was only slightly over HUF 380 thousand, 40 to 50 percent of which, on average, was financed from the loan.

Another characteristic of the small sound demand for loans is that, although some banks set maximum loan amounts, in practice issued loan value is limited by the regulation by the income of the borrowers rather than by the resources of the banks.

Loans for Developers

The restructuring and privatization of housing construction firms was a constraint, while the possibility of free enterprise was an incentive for new developers.

The majority of firms in the housing construction market are small- and medium-size enterprises with low equity, which, even with the housing construction subsidy, is hardly sufficient to finance construction. Although in real estate development it is a principle to finance development from someone else's resources, in order to qualify for loans developers have to put up the required collateral which is at least 150 percent of the loan.

Own capital and assets are supplemented primarily from buyers' pre-payments which amounts to 20 to 50 percent of the total purchase price, and in some cases 100 percent before the project starts. (In the latter case buyers can buy at reduced prices.)

In 1997 nearly 25 banks provided loans for developers to build housing. According to our estimates, eight of them provided larger loans but none of the banks have a monopoly in the developer market. Data show that 96 percent of loans for developers and 84 percent of the total volume were interest subsidized in 1996 and 1997—i.e., the main drive for lending was the subsidy (see more later). Our non-representative survey of banks¹² found the following important information on loans for housing developers.

¹² In the non-representative survey commissioned by USAID, all banks involved in lending for housing developers were contacted. Of questionnaires returned, nine could be evaluated, concerning certain questions even fewer.

Table 16
The Terms and Characteristics of Construction Period Loans for Developers

Terms of Loan	Amount
<i>Between January 1, 1996 and December 31, 1997 (HUF million)</i>	
Average loan amount	67.5
Average minimum loan	22.3
Average maximum loan	252.2
<i>End of 1997</i>	
Average annual interest rate	25.6%
Average annual transaction fee	1.1%
Average maturity period (89% of loans are repaid within one year ^a)	1.1 year
The average share of the loan in total investment costs	73%
The average share of the loan in invested own capital	300%
The share of the collateral as a HUF amount in the loan as required by banking	134%
The share of the collateral as a HUF amount in the loan in practice	142%

Note

a Average figure (n=6)

Source: Metropolitan Research Institute

The table shows that developers took out loans for a very short term to be able to make use of the interest subsidy. Loans, however, amounted to as much as 70 percent of investment costs. Banks required of developers extremely large collaterals, even larger than required by regulations.

In the experience of loan institutions, the demand of developers for construction period loans has increased in the past two years. There are, however, much fewer contracts signed than the demand. Loan institutions reported that there are several general problems that are obstacles to lending to developers. Banks regard lending to developers risky, mainly because developers are primarily small enterprises with little equity, equipment, unreliable occasional work force, few references and insecure orders for the future. Currently anyone may start a housing project for there are no professional standards or criteria. In Hungary there is no traditional cooperation of the three parties (the developer, bank and buyer) in the financing of the housing project. Developers often do not have the required collateral and ownership rights concerning the construction land is in many cases unclear. Some developers do not have a fair understanding of the demand and eventually are not able to sell the units.

Some problems of the banks are felt in the retail market as well. To foreclose collaterals is difficult and in case of non-payment of bankruptcy the bank's claim ranks only fifth or sixth because public debts are the priority. On the buyers' side, too, foreclosure is difficult for evictions do not occur in practice.

SUBSIDY PROGRAMS CONNECTED TO HOUSING FINANCE

In the housing system prior to the change of the regime, the housing finance and the housing subsidy systems were intertwined. It was much discussed whether the shift towards a market-based housing system would separate financing from subsidies. The real value of subsidies has decreased but part of the subsidies is connected to housing financing. The efficiency of these subsidy programs (interest subsidies, service subsidies, contract savings premium and guarantees) is widely questioned by experts. A detailed analysis of the subsidies is given in a separate paper;¹³ here a short overview and evaluation of the most important programs is given.

Interest Rate Subsidies for Housing Construction and Purchase

In 1989 fixed interest rate loans were replaced by the amortization subsidy that functioned until December 31, 1993. The new scheme offered market interest rate loans or upon certain conditions amortization subsidized loans for builders or buyers of new housing, instead of fixed interest rate loans.

In 1994 outstanding service subsidized loans fell by HUF 12 billion, in 1995 by HUF 16 billion to HUF 79 billion. The reason for the decline was that interest rates grew and the subsidy was reduced every five years. In August 31, 1997 outstanding loans were as little as HUF 43.2 billion, in 1997 HUF 11 billion and in 1998 are expected to be at HUF 9.5 billion.

Interest subsidy for loans is in force as of January 1, 1994. For 15 years the central budget subsidizes interest payments on loans borrowed to build or buy new housing up to HUF 2,800,000 for families with children or young couples planning children and HUF 600,000 for other borrowers. The subsidy in the first five years is 4 percent of the principal debt at the beginning of the maturity period, in the second five years 3 percent, and in the third five years 1 percent.

A personal income tax relief is granted to amortize housing loans (principal, interests and additional costs) taken after December 31, 1993. The size of the relief is 20 percent of the payable debt and not more than HUF 35 thousand. Loans spent on renewal or modernization do not involve any tax relief. Amortization of loans from housing savings banks are excluded.

The effect of the interest subsidy and the tax relief is doubtful not only because of the limited area of loans (new housing, standard housing claim and pre-set amount) but also because people do not perceive the actual size of the interest subsidy.

¹³ József Hegedhs. *Housing Subsidies and Housing Financing*. MRI, 1998

Subsidy for Housing Developers

The central budget subsidizes the interests of loans taken out by housing developers (enterprises, housing cooperatives and municipalities)¹⁴ if the borrower repays the loan in one, two, or three years. The interest subsidy is 75, 60 and 25 percent of the base rate of the bank of issue raised by 1.5 percent.¹⁵ In 1997 the amount of the interest subsidy was HUF 2 billion which is over 2 percent of all housing related expenditures and close to 4 percent of the total amount of housing subsidies (this subsidy is expected to have a similar share in central budget expenditures). Data show that the estimated amount of the subsidy is much less than the actual claim for it.

Subsidies for Renovation for Condominiums

Subsidized Renewal Loans for Condominiums and Housing Cooperatives

Renewal loans, subsidized by the central budget, can be provided by any bank involved in housing financing. In current practice it is provided by OTP. According to regulations, those condominiums are eligible for the subsidized loan that open a separate renewal account within 90 days of foundation, or have kept such an account for 5 years. The vast majority of condominiums do not meet this requirement.

The effect of the program is very limited. Annually, as few as 5 or 6 hundred contracts are signed involving an amount less than HUF 200 million.

Basically, OTP provides loans in two ways: (1) separate loans for each co-owner rating them individually, or (2) one loan for the condominium. In the case of issuing one loan too OTP requires the necessary collateral, i.e., requires each owner to ensure individual mortgage collaterals.

The German Loan Program

Six banks¹⁶ joined the energy conservation loan program, managed by the Hungarian Development Bank.

¹⁴ Ministry of Finance Decree No. 51/1985

¹⁵ In April 1998 the general market interest rate was 25.5 percent on loans repaid within one year; the subsidized interest rate is 10 to 15 percent depending on the credit rating.

¹⁶ Postabank., ABN AMRO – Hungarian Credit Bank., Hungarian Savings Cooperatives Bank, Raiffeisen-Unic Bank, Konzumbank, Rákóczi Regional Development Bank.

A sign of the successfulness of the program is that as many as six bank were interested, stimulating the competition in housing financing. However, actual lending was lower than expected.

There are several problems concerning lending to condominiums and cooperative housing. Banks participating in the loan program think that determining the collateral is too complicated and unsolved for those who request the loan. Co-owners of condominiums who own or have income from a unit (commercial unit, space for stocking) registered individually may put up the collateral jointly. However, in most condominiums commonly owned space is not valid as collateral. Thus banks – similarly to OTP’s practices of condominium lending – review individually the creditworthiness co-owners and mortgage the individual units. There has been no condominium specific rating system developed yet. Common representatives and co-owners do not know about banking enough and banks usually do not bother about informing their prospective clients. Co-owners do not trust central subsidies for they were cancelled a couple of times.

Contract Savings and Housing Savings Banks

Housing contract savings have a root in the regime prior to 1989. Though the scheme that time (Youth savings account) ensured a substantial subsidy, it was never demanded on mass scale for it was too rigid in terms of on what it could be spent. OTP’s contract savings schemes were replaced by housing savings banks. The competition has started, for deposits as for the time being, which may have a positive effect on housing loans. A serious disadvantage of the housing savings bank system is that it works towards the separation of housing finance from other financing mechanisms at a time when the integration of capital markets takes place in developed countries. Experts widely differ in their judgements of this process.

In Hungary housing savings banks have been operating since November 1996.¹⁷ The most specific feature of housing savings banks is that their loans are limited to housing, isolated from all other financial activities.

Housing savings banks operate as a special type of cooperatives of housing buyers. After four years of saving, these banks provide savers housing construction and renewal loans on a 6 percent interest rate. Savers are subsidized by the government to compensate them for the low interest, 3 percent, on their deposits during the savings period. So far four housing savings banks have been in operation: Fundamenta, Lakáskassza (Housing Fund), OTP, and Otthon (Home).

¹⁷ Bausparkasse has been functioning in Austria and Germany for a long time and similar systems have been introduced in the Czech Republic and Slovakia.

Table 17
Deposit Contracts in Housing Savings Banks, 1997-1998

Name	Number of	Number of	Total contract	Total contract	Average
OTP	122,000	136,000	102,000	110,000	800,000 –
Fundamenta	106,000	130,000	78,100	90,000	746,000
Lakáskassza	62,000	69,000	46,150	50,250	746,000
Otthon	—	around 1,000	NDA	NDA	
Total	290,000	336,000	226,250	250,250	

Source: Világgazdaság, Issue October 21, 1998

In the first two years interest in housing savings banks exceeded expectations. In 1997 290 thousand contracts were signed instead of 100 thousand expected. The number of contracts was so high because the government announced to reduce the subsidy. According to data in August 1998, the number of contracts signed this year is around 40 thousand. The low number is a danger because the resource for future loans is the current savings. It is possible that current savers will have to queue for loans after four years.

In 1998 four housing savings banks compete for clients. OTP is the first both in terms of the number of contracts and the volume of savings and it is closely followed by Fundamenta. Otthon, founded in 1998 in the cooperation of Konzumbank and an Austrian housing savings bank, has only 1000 contracts which is a sign that the market is saturated.¹⁸

Terms offered by the various housing savings banks do not differ; they offer similar loan products after four, six, or eight years of savings yielding 3 percent.¹⁹ The majority of clients (over 80 percent) chose short-term loans in all four of housing savings banks.

The disadvantage of saving in housing savings banks is that the change of net interest rates is difficult to predict, i.e., households are not able to foresee whether saving in another way would be more advantageous or not. For households, however, saving the optimum amount (HUF 10 thousand per month)

¹⁸ Nevertheless, Otthon has other expectations. According to international statistics, they say, they have many potential clients in Hungary. In Austria, for instance, over half of the population holds a housing savings contract while in Hungary only 3 percent.

¹⁹ On the optimum savings of HUF 10 thousand per month, Fundamenta provides HUF 1.25 million and Lakáskassza HUF 1.41 million. The monthly debt service is between HUF 12.500 and 13.113. The maturity period is 64 months.

will generate a return that may exceed revenues available from any other alternatives.²⁰ The reason for this is that the government set the amount of the subsidy in 1996 for the four years of savings. But as the inflation rate is increasing less fast, market interest rates are expected to fall in coming years to 12 to 15 percent, while interest rate guaranteed by housing savings bank was 17.5 percent including the subsidy, already in 1997, which will be ensured throughout the four years.

Another advantage housing savings banks ensure is that they encourage regular savings and fixed interest rates make the system predictable. However, in contrast to expectations, housing savings banks look into the solvency of borrowers, i.e., loans do not come automatically. The four year saving period itself provides a positive credit history which reduces loan risks which in turn reduce interest rates. In fact, at the moment, the interest rate of pre-loans on contract savings is lower than that of regular housing loans.

The housing savings system is not elastic in certain ways. On the one hand four years of savings time might just be too long for some families who, however, will not be eligible for the subsidy if they take out their savings earlier than that. On the other hand savings are best to take out right after the four years as later the net yield declines.

As savings are far from enough to buy housing, a large part of deposits in housing savings banks will be presumably spent on renewals. The assumption is also underlined by the fact that many condominiums and housing cooperatives, planning renewals, have savings in housing savings banks.

Unreliable forecasts about the number of contracts make budget subsidies unpredictable. The total amount of subsidies in the first period will be three times as much as planned (HUF 7 billion) to be paid by the government within 2 months after 12 months following the contract (i.e., in 1998 and early 1999). As this type of savings is attractive for many reasons, subsidies may amount to HUF 15 billion by the year 2000.

The savings scheme of Otthon is essentially a contract savings connected with a life insurance. Axa Colonia's housing financing program, which in fact is a life insurance, is designed to benefit from all available central subsidies. In this program clients take out a 19- or 20-year life insurance policy and similarly to housing savings banks, in 4 or 5 years they can take out a loan from one of the partner banks: Daewoo, Creditanstalt, or Konzumbank. From insurance premiums accumulated in the savings period, Axa Colonia services the principal debt and clients have to pay only the interests. Axa Colonia provides loans at a lower than market interest rate because its risks are lower for the savings are a collateral and regular payments by clients are a reference of solvency. In the life insurance program, 20 percent of premium payments, and not more than HUF 50 thousand is deductible from the personal income tax, the client is

²⁰ As the central subsidy is maximized, this assumption is true only if households save the optimal amount every month.

entitled to a 30 percent central subsidy on the housing savings and is eligible to all tax reductions connected to housing loans.

In summary, it seems that the primary advantage of housing savings banks is the central subsidy that is connected uniquely to these programs. The system, however, is vulnerable if the number of clients drastically declines and queuing for loans takes too long. Contracted amounts ensure but 10 to 15 percent of housing financing thus are only a subsidiary resource in buying or building housing, and may play an important role in renewals and utility improvements. The housing savings program is a replacement for the youth savings account system though central subsidies on savings are much less.

INNOVATIONS IN VARIOUS AREAS OF HOUSING FINANCE

In housing finance many innovations have appeared, adapting to current legal, economic and financial conditions, sometimes involving huge central subsidies.

Deferred Payment Mortgage (DPM)

DPM, a special loan scheme for inflation ridden economies, was developed by OTP with USAID technical assistance. In DPM the affordable amount of loan is larger because the monthly service is adjusted to the borrower's changing real income.

In 1996 and 1997 OTP issued more DPM loans to buy or build new housing than traditional loans with variable interest rates. Although the number of DPM loans was lower than that of variable interest loans, the average loan size was nearly twice as much. By the end of 1997 OTP had 6500 DPM contracts and 200 loans for buying and renewing secondhand housing. In 1997 16 percent of the 9500 new loans, or 1521 were DPMs, a huge increase from the original 3 percent.

Housing Clubs and Real Estate Lease

Due to the lack of capital and adequate loans in the upper segment of the housing market, various leasing and stock schemes have appeared to buy expensive housing.

Buyers' clubs are an alternative, though only subsidiary resources in housing finance, and are often not trusted by buyers. Housing clubs involve small groups of buyers, who pay a certain amount in a "fund" every month. The accumulated money is given or lent to a club member, who either is picked by drawing lots or by bidding, to buy housing. The bidding is won by the one who offers to pay the largest amount of the total price of the housing. Some club members can buy their housing in one month but some have to wait several years. Some of the clients obtain a ten year loan and have to pay only transaction fees. Required

monthly payments are adjusted for inflation, however, the value of the real estate grows as well.

Buyers' clubs use payments from buyers without having clear legal regulations; these clubs could in theory invest funds without informing members.

New housing is mortgaged by the club, or requires the buyer of the housing to take out a life insurance policy to protect other members. Clubs, like banks, have the housing appreciated and often require a guarantor.

To our knowledge, currently there are five housing clubs which refused to provide data on the number and amounts of their loans.²¹

Table 18
Terms of Loans in Housing Clubs

Name	Minimum/maximum	Maturity period	Own	Other use
Polygrupo	HUF 500 thousand	3, 5 or 9 years	Not required, though	
Pannongen	No limits	max. 20 years	Not required, though	
Promo Indra	HUF 800 thousand	3-10 years		To buy
Carat	50 ezer -max . no	2,4,5,9 years	Not required, though	No restrictions
Euro-Cass	HUF 100 thousand	3 or 9 years	Not required, though	On renewal too

In housing leasing schemes, buyers obtain loans in a matter of days as the basic guarantee for the loan is not solvency but the housing itself. Leasing companies provide their clients outside resources at a higher than market interest rate. In most of the cases, the client does not get cash but the leasing company buys the housing and retains in its ownership until the lease loan is repaid. The collateral and guarantee of the loan is the property itself in which the client sits as tenant as long as the loan is not fully repaid.

Mention Real Estate Lease Co. provides loans HUF 1 to 5 million (the amount is limited by resources) to clients buying relatively low value housing. The company may finance as much as 100 percent of the purchase price of the housing but clients often put up some of the purchase price themselves which is taken by the company as lease fee. The maximum maturity period for the loan is 10 years and monthly amortization payments change in function of the base interest

²¹ Three housing clubs supplied data on the number of their clients: 2000 (Eurocass) of whom 1000 have already taken out a loan. Promo Indra has 10,000 members and the average size of the loans is HUF 2 million. This club has a widely expanded network in the countryside that serves rural and not so wealthy clients. In Carat the number of clients is 1,500.

rate.

Land Credit and Mortgage Bank

In April 1997 law 1997/XXX on mortgage loans and mortgage deeds was passed and the Land Credit and Mortgage Bank was established with government support. The bank started operating in March 1998 and will be able to provide loans worth a total HUF 12 billion.

The bank finances projects with a long-term return, including construction period loans, and housing purchases. Current loans are financed from its HUF 3 billion of equity capital and inter bank loans. The bank is planning to issue long-term bonds in the near future, probably this year. The collateral security of bonds is the current real estate portfolio already at disposal to issue the first bond package. Bonds have not been issued so far because of the depressed stock market. The real question is what rating these bonds will get, which can have an impact on the housing finance market in the long run.

One of the new retail loan schemes²² offered by the Land Credit and Mortgage Bank is a housing purchase loan with a lower limit of HUF 3 million and an upper limit of HUF 20 million, but not more than 60 percent of the value of the property purchased and serving as collateral. The new loan schemes were developed to reduce the minimum loan amount from HUF 5 million to HUF 3 million and to reduce the size of the loan from 70 percent of the value of property to 60 percent because these properties are less secure as collateral than high value real estate.

The so called real estate loans for private persons and businesses to buy, renew and develop real estate is designed to meet needs for larger credits than retail loans. The minimum amount is HUF 5 million and the upper limit is 70 percent of the value of the collateral or 80 percent of the purchase price. The bank does not provide subsidized loans.

Mortgage loan interest rates are in the lower brackets of housing finance interest rates and amount to 24-26 percent because each loan contract is certified as a public document as required by law. Although the fee for a public notary document can be very high, it is useful for the bank because no lengthy court procedures are required to foreclose in case of default. Commercial banks write public documents only in the case of large loans to businesses. In the area of retail loans, risks for the Land Credit and Mortgage Bank are smaller than for commercial banks because in case of default it can obtain the collateral in a shorter time.

²² There are four loan schemes including the general mortgage loan, and loans to buy construction land or land.

The Land Credit and Mortgage Bank seems to be satisfied with its 60 or 70 housing loans issued, primarily for individuals (Magyar Hírlap October 2, 1998). The analysis of loan schemes shows that the bank is attempting to get a piece from the upper segment of the market. In the area of construction period loans for businesses it expects fierce competition from Western banks that have been providing such loans, including centrally subsidized ones.

The Mortgage Bank expects to provide larger than average retail loans, though newly developed loan schemes prove that there is a substantial demand for small amount loans. Despite that none of the banks have specialized in financing expensive housing, it is uncertain what portion the Mortgage Bank will be able to acquire from the market of retail housing loans. Currently OTP and foreign banks, including Hypobank, are planning to introduce mortgage loans.

Reverse Mortgage

The Reverse Mortgage Program is in fact a variety of the reverse mortgage loan that is known in economies with developed financial supply. The name comes from the English language; the borrower repays debt by selling his/her housing in the future.

The Reverse Mortgage Program is a sub-type of the reverse mortgage loan. The elderly person may live in the housing as long as he/she lives and is paid an annuity every month regardless that the value of the housing is even much less than what he/she has already received.

The Budapest City Estate Co. has been providing a reverse mortgage since 1992 primarily for owners of privatized units. The company has contracts with nearly 120 elderly. The objective of the contracts is to help the elderly pay housing costs. Data show that amounts of the annuity are not systematically in function with age and value of the housing. The company balances out payments to its clients, i.e., overpays clients owning small value housing and underpays those in large value housing. Many times, there is a twofold difference in annuity payments for similar age clients in similar value housing. Contracts are negotiated individually thus clients do not know about payments to others.

Table 19
Data on the Housing Annuity Program of Budapest City Estate Co.

	Districts						
	Prestigious	Other					
Business value	8,241	3,277	7,968	3,296	3,360	2,219	3,687
Average surface area	52	43	69	55	47	39	48
Number of contracts	9	14	5	28	41	22	119

Source: Hegedüs and Kovács, 1998

The most important risk factors of the annuity for housing program are: (1) the trend in real estate prices is projected to follow inflation; (2) ensure the collateral for the annuity if the program adjusts annuities for inflation; (3) expected low resource costs; and (4) higher than expected inflation rate.

There are plans to set up a reverse Mortgage institution with government support. According to these plans the MFB bank (Hungarian Development Bank) or MKB (the Hungarian Commerce and Credit Bank) sets up a joint stock company to operate such a program. In the beginning, activities will focus on Budapest and expand to cities with county rights as early as early 1999. Resources are to be financed from low interest rate bonds similar to treasury bonds.

CONCLUSIONS

The operation of the housing finance systems can be well explained by the “portfolio theory” (Buckley-Gurenko, 1996). According to the theory, the more a housing finance system relies on the market:

The less the use of salaries and savings of households is distorted, and as a result, the return on housing savings and other saving possibilities is the same if corrected for the difference among risks (the ratio of r_m/r_h approaches 1, where r_m is the return on a non-housing portfolio and r_h is the return on a housing portfolio).

The larger the freedom of individuals over the use of their savings.

The housing sectors of Central-Eastern European countries could be characterized by a low level of control over the households’ saving decisions before the political changes. However, the return on housing savings exceeded the return on other portfolios (cash, etc.) therefore the ratio was close to zero. The question is what happens during the transition? By reviewing the changes of the housing finance sector in the 1990s our hypothesis is that the “crisis” of the housing sector is a result of the modification of the portfolio decisions and spending preferences of Hungarian households. This impact was strengthened by the distortion effect of the high transaction costs of the housing subsidy system and the underdeveloped institutional system (market organizations, information, legal background, enforcement).

Applying the portfolio theory, we can conclude that after the political changes the power of households over their saving decisions increased a bit, however a more important change is the increase of the ratio towards 1. We proved that by analyzing the inflation, the prices on the

real estate market and the return on savings.²³ The changes in the housing investments, the analysis of the housing market, the changes of the housing price/revenue ratio, the decline in housing lending all underlie this statement.

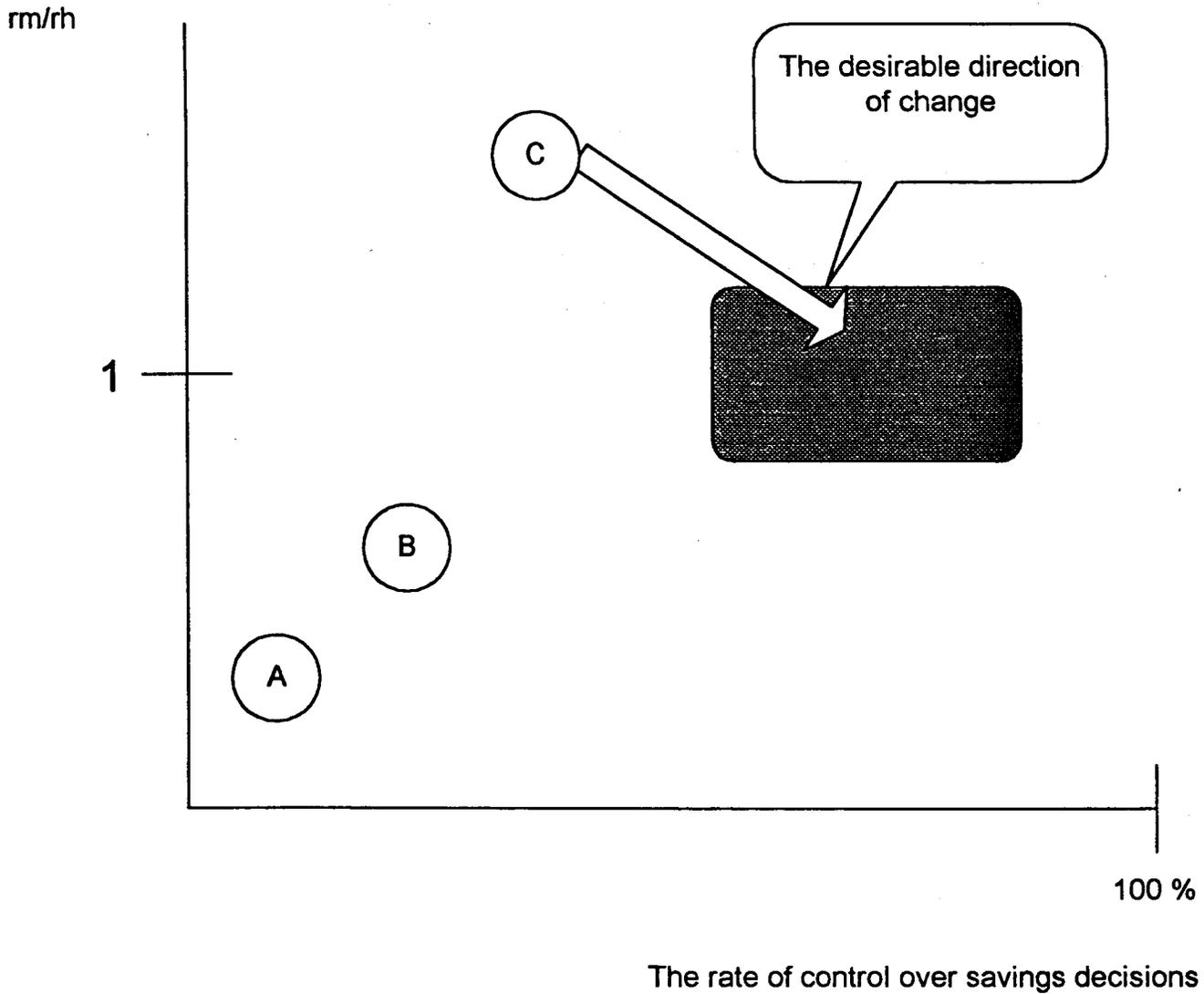
An important conclusion is that this change took place as a self-strengthening process, which means that its direction may turn quickly, in case the macroeconomic conditions improve. However, there is a danger that under uncertain economic conditions (high inflation, macroeconomic instability, etc.) the ratio will reach a low value (see Figure 1).

The key issue here is the stability of the institutional and subsidy systems and the legal background. Until the real incomes decline as part of the main macroeconomic trends, the distortion effect of the appropriate institutional system is not obvious. However, under more favorable economic conditions, this problem will become more apparent.

²³ Buckley and Gurenko supposes that the ratio further decreases during the transition; however, the facts seem to contradict this theory.

FIGURE 1

The direction of change in the housing finance system: the application of the portfolio model



A: The original East-European housing model

B: The Hungarian model

C: The model of the transition

On the basis of Buckley and Gurenko

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